Andy Powell

Boosting **government** productivity

To pay for the care of the elderly, developed societies face plummeting levels of public services for everyone else—and soaring taxes. Productivity could be the answer.

Thomas Dohrmann and Lenny T. Mendonca

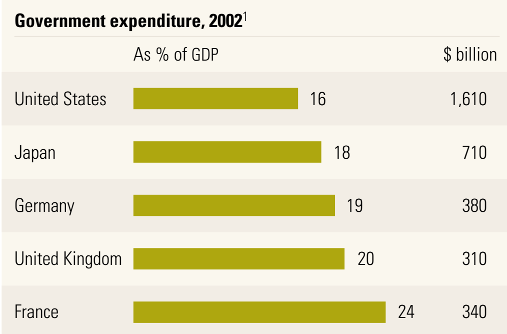
The costly retirement of 76 million US baby boomers will swell the ranks of the elderly to more than 20 percent of the population of the United States during the next 20 years. In Europe and Japan, the elderly will come to account for more than 30 percent of the population during the same period. This transformation is about to create a new sense of urgency to get the most from every government dollar. Public services beyond health care and pensions for seniors will face epic squeezes, and officials will struggle to balance the needs of retirees and younger citizens while still holding taxes to politically acceptable levels. Boosting the government's performance will be an imperative no country can ignore.

To be sure, attempts have been made before. In the United States, former Vice President Al Gore's efforts to "reinvent government" in the early 1990s scored some successes. The administration of President George W. Bush has made efforts to reform civil service rules that inhibit some sensible management practices. The Government Accountability Office (formerly the General Accounting Office) has shown perennial leadership in prodding government departments to address their management challenges. In the United Kingdom, Peter Gershon's recent review of government efficiency[1] has galvanized work to improve productivity across the public sector, with a target of £20 billion in savings by the end of 2008.

[1] Peter Gershon, *Releasing Resources to the Front Line: Independent Review of Public Sector Efficiency*, July 2004 (www.hm-treasury.gov.uk).

EXHIBIT 1

A large share



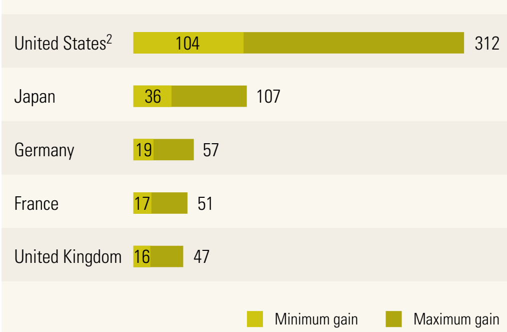
[1]Includes all expenditures incurred by governments on goods and services consumed either by individuals (eg, education) or collectively (eg, defense, police); excludes all transfers (eg, retirees' pensions).

Source: Organisation for Economic Co-operation and Development

EXHIBIT 2

The rewards could be great

Estimated value (after 10 years) of potential annual gains from increasing public-sector productivity,[1] $ billion



[1]In 2002 dollars; calculated as potential reduction in spending made possible by 5–15% increase in productivity.
[2]Medicare, Medicaid included in base spending.

Source: Organisation for Economic Co-operation and Development; UK Office of National Statistics; US Bureau of Labor Statistics; McKinsey analysis

But veterans of reform efforts agree that they have barely begun to scratch the surface of the government's performance potential. One reason is that reforms take sustained attention—often rare when they become caught up in partisan or interest group politics. What's more, political cultures remain oriented to legislation, not to executing and managing programs. Few people make their name by improving the way government runs.

Nonetheless, the coming era's extraordinary fiscal pressures will force leaders to overcome these obstacles. In the developed world, the state commands a large share of the economy, so improving the performance of government departments can generate hundreds of billions of dollars of value (Exhibit 1). Our experience working with public institutions in 50 countries has shown us that the opportunity, though hard to capture, is large enough to take some of the sting out of the hard choices that aging societies face. With the first baby boomers becoming eligible for retiree health and pension benefits in just a few years, there is no time to lose.

The size of the prize

Productivity lies at the heart of government performance. Although many people think that improving productivity is synonymous with cost cutting and layoffs, this misconstrues its real meaning: the amount and quality of the goods and services that can be generated with a given set of inputs.

Improved productivity can certainly be achieved by reducing inputs, but it can also come from increasing the quality or quantity of the output. In fact, layoffs often lead to poorer service and thus to lower productivity; perhaps paradoxically, boosting productivity can bring both cost savings and better service.

Either way, rising productivity—whether in the public or the private sector—is the key to rising living standards. In the US semiconductor industry, for instance, productivity growth averaged 75 percent a year from 1993 to 2000 because of advances in processing speed. The price of chips stayed roughly the same, but since they were more powerful and valuable to consumers, the industry's productivity increased. In the public sector, improving educational outcomes or reducing recidivism among criminals could likewise raise productivity even if more money was spent to do so. Collecting a higher percentage of the taxes owed by people and companies would improve the productivity of tax departments.

*Layoffs often lead to poorer service and thus to **lower productivity;** boosting productivity can bring both cost savings and better service*

Huge potential savings or quality improvements could come from raising government productivity, which in ten years could increase by at least 5 percent in the United States and perhaps by 15 or 20 percent—estimates that are almost certainly conservative. The potential gains in other countries are equally impressive (Exhibit 2).

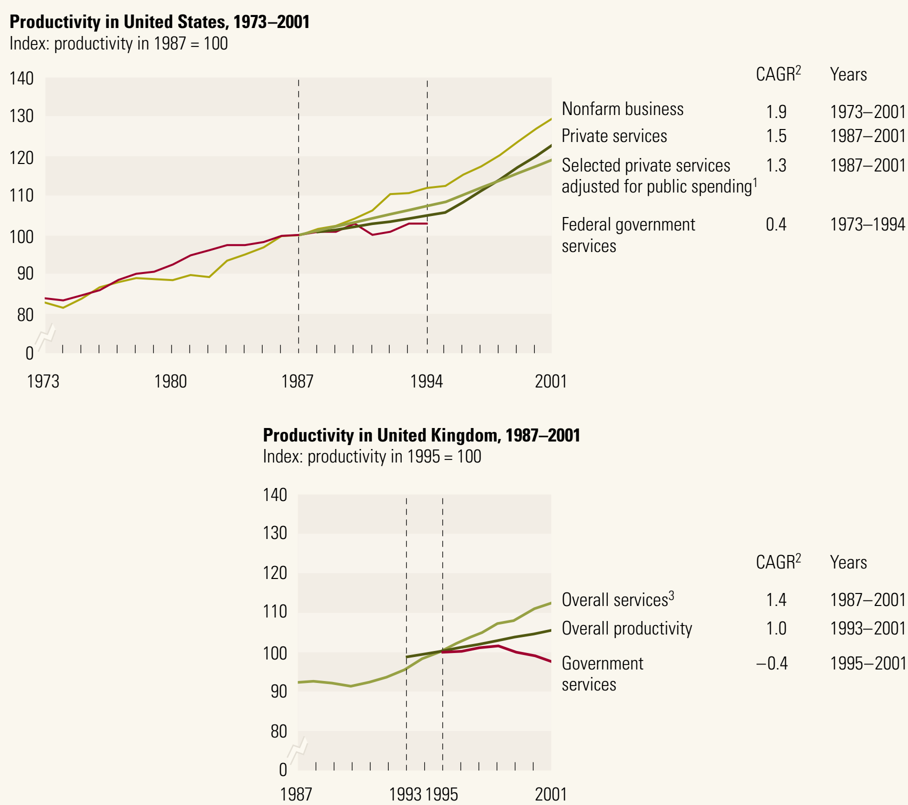
Admittedly, estimating the public sector's productivity is problematic because some of the data are sketchy at best. From 1969 to 1994, the US Bureau of Labor Statistics (BLS) experimented with productivity measures for key government functions, only to stop because of budget cutbacks and the waning interest of policy makers. The BLS metrics used results reported by government agencies and, in some areas, were not adjusted for the quality of services and value added. Yet even imperfect information offers a basis for assessing the value at stake.

To estimate the potential productivity gains, we start by comparing the productivity growth rates of the private and public sectors. For the United States, we use national-accounts data for the private sector and data from the Federal Productivity Measurement Program for the public sector. Of course, these two data sets use different selection and measurement methods, so it isn't possible to compare absolute productivity levels. But we can use the data to compare each sector's productivity growth rates and thereby to produce at least a rough estimate of the value at stake from improving government productivity.[2]

The data show that productivity in the public and private sectors rose at roughly the same pace until 1987, when a gap appeared (Exhibit 3). The private sector's productivity rose by 1.5 percent annually from 1987 to 1995 and by 3.0 percent annually thereafter. In contrast, our best estimates show that the public sector's productivity remained almost flat, rising by just 0.4 percent from 1987 to 1994, when the BLS stopped

EXHIBIT 3

The public sector lags



[1] Includes education, healthcare, and other private services weighted according to share of total public spending on services (excluding transfers: eg, retirees' pensions).
[2] Compound annual growth rate.
[3] Includes all private and public services (the latter accounting for ~33% of total spending on services).

Source: Jack E. Triplett, visiting fellow in economic studies at Brookings Institution; UK Office of National Statistics; US Bureau of Labor Statistics; McKinsey analysis

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[2] For a full description of the challenges of comparing the two data sets, see Donald Fisk and Darlene Forte, "The Federal Productivity Measurement Program: Final results," *Monthly Labor Review*, 1997, Volume 120, Number 5, pp. 19–28.

measuring it. No evidence suggests that since then it has experienced the growth spurt enjoyed by the private sector. A similar and growing gap appears in the United Kingdom as well.[3] Data on government productivity in other countries are not available. If the US public sector could halve the estimated gap with the private sector, government productivity would be 5 to 15 percent higher in ten years, generating $104 billion to $312 billion annually.

Is it fair, though, to compare productivity growth in the public and private sectors? The economist William Baumol famously noted in 1967[4] that services may lag behind manufacturing in productivity because their labor-intensive nature makes it hard to apply cost-saving technological innovations: it will always take the same amount of time for a teacher to read a story, for instance, or for a nurse to give a shot. In this view, since the public sector largely provides services such as education, health care, and law enforcement, there is little scope for productivity improvements.

Yet Baumol's reasoning may not be as conclusive for government today as it seems. Technology is just beginning to change the nature of service delivery in health care and education fundamentally. Moreover, most government activities have direct private-sector analogs. Processing Social Security payments or tax returns resembles processing insurance claims. Managing logistics and real estate is much the same in the public and private sectors. So is procurement. Private enterprises have found ways to boost their performance substantially in each of these areas, and there is little reason to think that the public sector can't.

*Most government activities have private-sector **analogs;** processing Social Security payments resembles processing insurance claims*

Our estimate of the size of the opportunity is also in line with work done by other credible researchers. John Wennberg and his colleagues at Dartmouth College, for instance, found that productivity in health care could increase by up to 25 percent.[5] Their work shows that the substantial regional variations in US Medicare costs are not associated with

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[3] The UK Office of National Statistics is revising its metrics, and the public-sector productivity numbers may rise, although there are no indications that they would equal or surpass those of the private sector.

[4] William J. Baumol, "Macroeconomics of unbalanced growth: The anatomy of urban crisis," *American Economic Review*, Volume 57, Number 3, pp. 415–26.

[5] Elliott S. Fisher, Daniel J. Gottlieb, F. L. Lucas, Étoile L. Pinder, Thérèse A. Stukel, and David E. Wennberg, "The implications of regional variations in Medicare spending," *Annals of Internal Medicine*, 2003, Volume 138, Issue 4, pp. 273–87. John Wennberg, the director of the Center for the Evaluative Clinical Sciences, at Dartmouth Medical School, pioneered research into regional Medicare patterns. The paper cited in this footnote has David Wennberg, another researcher, as one of its authors.

How Illinois cut its purchasing bills

With huge swaths of the labor market set to retire in the coming years, the public sector will soon face intensifying pressure to top up its coffers in order to provide services for aging citizens. More people living on fixed incomes mean that state governments can't rely on the personal income tax and other traditional revenue boosters to fill budget gaps. Alternative revenue generators, including casinos and lotteries, are already showing their limitations.

To stanch the red ink, it will be necessary to take a hard look at the other side of the equation: cost-management and procurement policies. Increasingly, governments will have to borrow best practices from the private sector and alter them to suit agencies that often not only don't enjoy the degree of managerial freedom that prevails there but also face strong resistance by employees to change. Such obstacles may have prevented the earlier adoption of private-sector practices, even as the dot-com bust and the economic downturn of 2001 upended the budgets of states, local governments, and school districts, making more efficient management necessary.

Purchasing is one area in which states can innovate successfully despite these barriers. Last year, Illinois transformed its procurement system, a patchwork of agencies stitched together over the past 175 years. In the process, it saved roughly $110 million out of the $15 billion spent each year on goods and services, such as prison food, phone calls, and copy machines. For fiscal year 2005, the state is on track to save twice as much.

The way Illinois achieved these savings provides lessons for other state governments. By the time it began its transformation process, in 2003, it had become a conglomerate of more than 100 agencies, departments, and commissions, which in all spend more than $50 billion a year. If the state were a private-sector business, "Illinois Inc." would rank in the Fortune 100. Each agency or department has its own budget and determines its own spending needs—the notion being that the missions and corresponding strategies and operations of different agencies vary greatly, so they require as much flexibility as possible. The state's decentralized model, however, creates some predictable difficulties, such as the signing of a number of contracts for the same items and a failure to leverage the state's purchasing power or to share learning across agencies. A "silo mentality" reinforces these difficulties. The all-too-familiar results are financial deficits, poor service levels, project delays, budget overruns, and low organizational morale.

Illinois set out to transform its purchasing culture by promoting a new, centrally led, One State model to help it procure goods and services as a single entity. Hundreds of employees throughout the state helped plan new purchasing strategies and in the process gained training in the new approach.

differences in access to health care, its quality, or health outcomes. Reducing costs in all regions to those in the lowest quintile (adjusted for differences in the prevalence of illness, medical prices, age, sex, and race) would cut annual Medicare spending by about 20 percent without affecting the recipients' standard of care.[6] Such a transformation implies a productivity increase of 25 percent. Furthermore, David Brailer, the

[6] Elliott Fisher and Jonathan Skinner, "Regional disparities in Medicare expenditures: An opportunity for reform," *National Tax Journal*, 1997, Volume 50, Number 3, pp. 413–25.

Amid these efforts to shake up the state's purchasing culture, Illinois designed a two-pronged effort to drive down spending. The first was a "quick-sourcing" initiative that used benchmarked prices as a tool to renegotiate contracts with vendors. The second was a total-cost-of-ownership (TCO) approach focusing on two major spending questions—what to buy and how to buy it—which help determine all of the long-term cost elements of an item and all of the drivers of those costs.

Quick sourcing relies on the premise that vendors will renegotiate their contracts in the state's favor when confronted with benchmarking data showing that they may have overcharged for goods or services in the past. It helped Illinois to identify $30 million in annual savings, including $3 million a year for telephone bills alone. The benchmarking information has been included in a new online database, so that future negotiators—no matter what their agency, department, or commission—can take advantage of the work already completed.

In addition to the price cuts earned through quick sourcing, Illinois deployed TCO methods to find an additional $80 million in savings during the initiative's first year. By focusing on what to buy, for example, the state Department of Corrections saved $2 million a year on prison food, in part by eliminating costly items (such as tuna and grapefruit) from the menu and replacing them with less expensive but comparable items, such as ground beef and oranges. In most cases, the challenge came in convincing officials that the substitutions and cuts wouldn't result in inferior services.

After looking at how to buy—the other major aspect of the state's TCO approach—a team from a number of agencies recommended, among other things, that Illinois attempt to consolidate all of its contracts for temporary services. The decentralized hiring of clerical workers had been an attempt to accommodate the divergent needs of different agencies but meant that the state had not been able to leverage its size to get better prices. By combining contracts, it saved $2 million during the first year. In this case, changing how the state bought services involved coordinating the needs of agencies that had rarely collaborated in the past. The change also posed a new political challenge: fewer contracts mean that the state has fewer opportunities to expand the amount of business it does with companies owned by members of minority groups and by women.

The experience of Illinois shows that state and local governments adopting best purchasing practices can achieve big savings. Clearly, however, for these procurement approaches to succeed, states must transform their cultural DNA.

Chip W. Hardt and Ravi P. Rao

Chip Hardt is a principal in McKinsey's Chicago office, and **Ravi Rao** is a consultant in the Cleveland office.

new national coordinator for health information technology at the US Department of Health and Human Services, estimates that widespread modernization of the IT infrastructure will eventually reduce national health costs by 10 percent through administrative and clinical savings. Business Executives for National Security found that the Pentagon wastes up to 10 percent of its budget compared with more efficient private-sector organizations in functions such as housing, inventory management, payroll processing, and travel. Whatever the precise figure, all evidence points in the same direction: the opportunity to improve government productivity is huge.

Boosting the performance of government

Let us be clear: calling for a new focus on government productivity isn't meant to serve as a justification for thoughtless cuts in government spending or for "union bashing" inspired more by ideology than by a quest for effectiveness. Nor is it meant to induce complacency in the face of the hard budget choices that aging societies will face.

Instead, our call to action is meant to promote a necessary conversation on the role that government productivity can play in making the coming fiscal challenges more manageable and humane. In an era of permanent fiscal pressure, liberals should welcome a more efficient government to assure that more money is available for social needs. Conservatives should welcome it to help keep taxes at levels consistent with strong economic growth. Rightly understood, better performance by government can become that rare arena in which common ground is possible.

Over the past decade, a handful of public-sector organizations around the world—schools, public-welfare agencies, health care systems, postal and transit systems, and militaries—have improved their performance by 5 to 30 percent or more. Often they have chosen among three classic management tools to raise productivity: organizational redesign, strategic procurement, and operational redesign. In the most effective cases, these tools were part of a broader program of cultural change that transformed the organization's performance and measured it rigorously.[7]

Organizational redesign

A redesign that focuses on the end "customer," eliminates duplication, and streamlines processes can improve both the cost and the quality of services (see "Organizing for effectiveness in the public sector," in the current issue). Consider the experience of the US state of Illinois. In 1997 it put public-aid programs from six separate departments under a single roof. Previously it had been necessary to approach each of them separately and to give them the same information, even though more than half of their 1.8 million customers received more than one service. The new Department of Human Services is a one-stop shop ensuring that recipients get all of the services they need—in the past many of them hadn't—and eliminating the duplication of programs and back-office processes. As a result, the department has redeployed money and staff to new programs, such as an early-intervention initiative.

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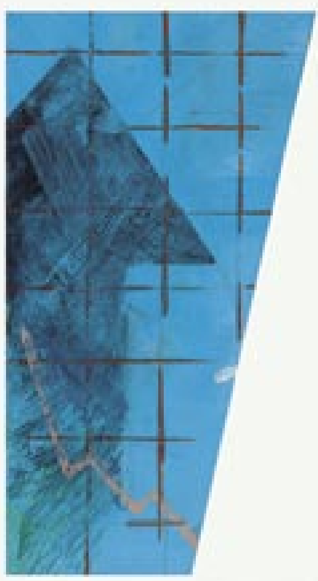
[7] Emily Lawson and Colin Price, "The psychology of change management," *The McKinsey Quarterly*, 2003 special edition: The value in organization, pp. 30–41 (www.mckinseyquarterly.com/links/14579); Jennifer A. LaClair and Ravi P. Rao, "Helping employees embrace change," *The McKinsey Quarterly*, 2002 Number 4, pp. 17–20 (www.mckinseyquarterly.com/links/14581); and Jonathan D. Day and Michael Jung, "Corporate transformation without a crisis," *The McKinsey Quarterly*, 2000 Number 4, pp. 116–27 (www.mckinseyquarterly.com/links/14583).

The German Federal Employment Agency (Bundesagentur für Arbeit) is also reorganizing, amid a controversial and often bitter public debate about the future course of German social and labor policy. Headquarters have been shrunk down to 400 staff members, from 1,100, and operational responsibilities have in effect been decentralized to ten regional divisions. The radical redesign of local agencies and their service offerings has been successfully prototyped and now gives customers tangible benefits, such as halving waiting times and doubling the amount of time available for counseling. These changes have led to much higher customer satisfaction levels.



Procurement

Improving supplier-management and purchasing operations can help organizations cut their expenditures while raising the quality of the goods and services they buy. Governments mounting such efforts usually standardize and consolidate orders, designate preferred suppliers, reward them for meeting delivery and quality targets, and collaborate with them on ways to improve production processes and reduce costs. Government regulations sometimes make revamping public-sector procurement difficult, but enormous progress can still be made: Illinois saved more than $100 million in fiscal year 2004 and expects to save more than $200 million in fiscal year 2005 (see sidebar "How Illinois cut its purchasing bills," on the previous spread). For many items, the state is getting better quality.

Sometimes procurement officials cut costs dramatically by understanding the suppliers' economics. A US federal agency, for example, recently renewed an IT contract with outside vendors. By building a detailed model of the suppliers' costs and benchmarking their individual components, it negotiated prices that were more than 60 percent lower than the first set of competitive bids it received and will save several hundred million dollars over the term of a five-year deal.

These are not unique opportunities: Most government agencies could improve their procurement processes. The state of Tennessee, for instance, is projected to save more than $300 million annually in

Medicare and Medicaid costs, without any changes in health outcomes, by purchasing the cheapest drugs available rather than name-brand ones. Schools throughout the United States have saved 10 to 35 percent on food, janitorial services, textbooks, and transportation by purchasing them more astutely. (Large school systems can save $30 million to $40 million a year in this way.) Military and security spending is an even bigger opportunity, in part because it accounts for more than 70 percent of total government contracting. The United Kingdom is trying to capture this opportunity through its Smart Acquisition program, a set of reforms designed to reduce bureaucracy, cut procurement costs, and speed up the delivery of equipment.

You have mail, efficiently

Ever since Henry Ford came up with his revolutionary assembly line, manufacturing companies have constantly sought to raise their efficiency by redesigning operations. More recently, public-sector organizations have found that they too can boost productivity by reducing waste, eliminating unneeded effort, correcting mistakes quickly, and encouraging workers to suggest ideas for improvement.

A variety of challenges inspired the United States Postal Service to begin considering such an operational redesign in 1999. The number of addresses the USPS served was growing by 1.8 million every year, without corresponding increases in the revenue it generated or in mail volumes, which were projected to stop growing or even decline. Like many public-sector organizations, it faced regulations that, combined with its powerful labor unions, made it nearly impossible to close plants or to lay off workers. Moreover, largely as a result of having prices pegged to costs by the government, the USPS had developed a culture in which managers were rarely expected to improve productivity. In this environment, merely maintaining service levels and raising the price of stamps by rates at (or even below) the inflation rate counted as a success. Productivity had therefore been essentially flat for ten years, growing at only 0.2 percent annually, compared with the 3 to 5 percent expected in the private sector.

An initial analysis of the problems indicated that the best mail-sorting plants and delivery units were twice as productive as the least productive ones—and that potential opportunities to improve productivity were substantial. To pursue them, the postal service's leadership decided to launch what it called a "breakthrough productivity initiative."

A team of 15 people handpicked by senior management led the charge. The first finding was that performance data were murky at best: it was hard to tell with any real precision how well plants and delivery operations were performing or to compare performance across plants or delivery units. To remedy this problem, the team decided that detailed performance data should be captured by an information system and distributed through an intranet site where USPS employees could monitor the performance of every plant and delivery unit. Grouping all of the plants into seven categories, each with similar characteristics (such as size or layout), provided for meaningful comparisons.

First, the team used the data to set improvement targets for each plant and delivery unit and to lock them into budgets. While there was resistance

Operational redesign

Redesigning operational processes to reduce waste, eliminate unneeded effort, and correct mistakes quickly can also raise productivity to an astonishing extent. Consider the experience of the United States Postal Service (USPS). Since 1999, the number of addresses it serves has increased by seven million—nearly equivalent to the number of addresses in the entire Chicago metropolitan area. Nonetheless, the USPS has saved $5.5 billion by replicating the best practices of the best sorting plants and by improving its delivery and counter operations. In this way, it cut its full-time workforce to 69,000, mainly through retirement and

initially, the organization began to accept the new approach after a few budget cycles, and managers soon came to expect that they would be asked to increase productivity each year. A new incentive and recognition system rewards those who do. Second, to help managers meet their budget targets, the team used the data to reveal best practices throughout the organization. A sorting plant in New York City, for example, processed only 5 percent of its total mail by hand, versus a nationwide rate of 10 percent. The approach of the New York plant was simple: its workers quickly looked through mail containers destined for manual sorting and decided which of them could go onto its automated equipment. When the USPS applied this practice across all plants, it generated several hundred million dollars a year in cost savings, since manual sorting is actually ten times more expensive than automated sorting.

After the productivity improvements kicked in, a simple scheduling tool revealed that the USPS had more workers than it needed overall, even at peak times. The team therefore suggested ways of matching the organization's staff levels to its variable workloads. Nonetheless, throughout the whole labor-reduction process, the USPS leadership fully cooperated with the unions, avoiding layoffs entirely. Natural attrition, the use of fewer temps, and less overtime for some workers cut full-time employment levels by 15 percent, thereby creating a much leaner organization.

Although the breakthrough productivity team finds and disseminates best practices across the organization, the nine area vice presidents across the country are ultimately responsible for deciding how to meet their productivity targets. As this kind of accountability has taken hold across the organization's 380 mail-sorting plants and 27,000 delivery units, it has reduced the variability of performance among branches, standardized processes, and spread best practices to the worst performers. These achievements have in turn decreased the USPS operating budget by more than $5.5 billion—close to 10 percent—in four years' time.

Thomas Dohrmann and Stephen K. Sacks

Thomas Dohrmann is an associate principal and **Steve Sacks** is a principal in McKinsey's Washington, DC, office.

normal attrition, and increased its productivity by 6 percent. Customer satisfaction ratings and other service-quality metrics are at all-time highs (see sidebar "You have mail, efficiently," on the previous spread).

"E-government" initiatives too can radically improve service and customer satisfaction while reducing costs by 25 percent or more.[8] In Singapore, an export license that formerly required 21 forms and took three weeks to process now involves one online application that can be approved in 15 seconds. The US Internal Revenue Service can process an online tax return for just $0.40, compared with $1.60 for a paper return, and the Arizona Department of Transportation can renew a driver's license online for $1.60, compared with $6.60 at a branch office. Combining online deli-very with a redesign of the back-office processes supporting it can realize cost savings of 35 to 40 percent—while customer satisfaction soars.

Overcoming the barriers

If governments could improve their performance easily, they would have done so already. In fact, they face unusual challenges. Competition is the most important missing element. More than a decade of McKinsey Global Institute research around the world shows that monopolies, businesses protected by government regulation, and other private-sector companies without competitors nearly always have very low productivity.[9] Without competition, managers have little incentive to take risks on new techniques.

For governments, the solution is creating competition to provide services and giving citizens the ability to choose among these alternatives. Charter schools, for example, create competition in public education. Outsourcing back-office services such as procurement, real-estate management, and payrolls and benefits creates competition in these functions. Allowing private-sector companies to bid on social-service contracts lets them compete with government providers.

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[8] Gassan Al-Kibsi, Kito de Boer, Mona Mourshed, and Nigel P. Rea, "Putting citizens on-line, not in line," *The McKinsey Quarterly*, 2001 special edition: On-line tactics, pp. 64–73 (www.mckinseyquarterly.com/links/14585).

[9] William W. Lewis, "The power of productivity," *The McKinsey Quarterly*, 2004 Number 2, pp. 100–11 (www.mckinseyquarterly.com/links/14587).

A part of the answer for aging populations?

If sustained growth in public-sector productivity began now, it could contribute to some easing of the looming fiscal crisis that will accompany the rapid aging of the populations of developed countries. The Organisation for Economic Co-operation and Development (OECD) estimates that by 2050 public expenditures will have increased by an average of 6 percent of GDP to accommodate the needs of retirees.[1] But the Center for Strategic and International Studies (CSIS) argues that these projections are too optimistic and that increases in spending could amount to more than 12 percent of GDP by 2040.[2] Using assumptions lying somewhere between those of the OECD and the CSIS, we estimate that spending will increase by 8 percent of GDP in the United States, where higher birth and immigration rates are expected to make the impact of aging less dramatic than it will be in other advanced countries, and by more than 10 percent of GDP in Germany, where the aging trend is more pronounced.

The usual options for controlling the massive expenditures that will soon be needed to accommodate the elderly are reducing the level or growth of government benefits for them, cutting public services for the rest of the population, and raising taxes. Enhancing public-sector productivity could make any of these options less painful. In fact, raising it by an extra 1.4 percent a year in the United States and by an extra 1.6 percent in Germany would let their governments sustain current levels of public services and social-welfare benefits, without additional taxes or borrowing.

These are undoubtedly very large improvements, but they might be possible. After all, from 1987 to 1994 the private sector's productivity growth rate in the United States was 1.0 percent higher than the best estimate for that of the public sector. In the United Kingdom it was 1.8 percent higher from 1995 to 2001. Even if reducing the gap doesn't eliminate the fiscal impact of aging populations on its own, it could take some of the sting out of the hard fiscal choices societies will face coping with them.

[1] Pablo Antolin, Thai-Thanh Dang, and Howard Oxley, *Fiscal Implications of Ageing: Projections of Age-Related Spending*, OECD Economics Department working paper number 305 (2001).
[2] Neil Howe and Richard Jackson, *The 2003 Aging Vulnerability Index*, Center for Strategic and International Studies and Watson Wyatt Worldwide, Washington, DC, 2003; and Richard Jackson, *The Global Retirement Crisis*, Center for Strategic and International Studies and Citigroup, Washington, DC, 2002. Both papers can be found at www.csis.org.

When creating competition in the public sector isn't possible, its leaders can devise other incentives. For one thing, managers can be prodded to meet targets if governments budget in expected performance improvements; in the United Kingdom, the Gershon review of the public sector's efficiency has given each government department three-year productivity targets covering financial savings and head count reductions while at the same time ensuring that services will continue to be provided. Making the performance of governments more transparent by publishing the results of customer satisfaction surveys, benchmarking surveys, and service-quality metrics also helps citizens to take an active role in demanding change.

If the execution challenges are daunting, the principles and prerequisites for success are clear. When public-sector operations become more transparent, accountability increases. Benchmarking and tracking performance help managers to raise their game. Exposing activities to competition improves service and cuts costs. The keys are committed leadership, a critical mass of talent, processes that budget for productivity targets, and citizens who know that they have a stake in a better outcome and hold officials accountable for achieving it. One way of building public confidence and media support and of stoking the appetite for change is to design the reform effort so that it delivers high-profile early victories.

If not now, when?

Given the magnitude of the opportunity, there are only two paths forward. The first—government as usual—ensures that in the decades ahead citizens will pay higher taxes and receive fewer, lower-quality services while financing the baby boomers' retirement. Public alienation seems likely to deepen just when governments already face a talent crisis as a generation of managers heads toward retirement.

The other path—developing a serious and sustained agenda to boost performance throughout the government—won't be easy. But as part of a broad national effort to meet the challenge of an aging population, it could draw new talent to public service at a crucial moment. Today governments at all levels face an unprecedented loss of talent and institutional knowledge. Nearly three-quarters of all senior federal executives could retire in the next few years; in California, nearly a third of the state's entire workforce could. To inspire a new generation capable of filling the shoes of these retiring leaders, government must transform itself.

The public sector has guided some of history's most extraordinary ***management feats,*** *from the Manhattan Project to space flight*

If leaders of governments started to think differently about how they do and could work, the results would surprise the cynics. The public sector, after all, guided some of history's most extraordinary management feats, from the Manhattan Project to space flight to bullet trains to smallpox eradication. An agenda to revitalize government could make citizens more engaged with it, initiate a virtuous cycle of continual improvement, and ease the impact of an aging society (see sidebar "A part of the answer for aging populations?" on the previous page).

Even without a broad mandate, visionary government executives can begin making real progress on productivity in their own organizations. The leaders of the German Federal Employment Agency, Illinois, and the USPS have shown the enormous gains that can be made. By starting with less politically charged areas, such as procurement, government leaders can gain the experience and credibility to tackle more sensitive ones, including education and health care.

Unprecedented fiscal pressures that are only a few years away should promote a new kind of national conversation, in which shibboleths can be rethought. Leaders at all levels of government must consider how their own organizations can immediately start to plan and implement the performance improvements that advanced nations will desperately need. The time for action is now. Q

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Thomas Dohrmann is an associate principal in McKinsey's Washington, DC, office, and **Lenny Mendonca** is a director in the San Francisco office.